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SUBJECT: U.S. FIRMS PROTEST NEW TELECOM TAX

REF: 2007 SAN SALVADOR 2431

¶1. (U) SUMMARY. U.S. phone companies are contesting a four-cent-per-minute tax on incoming international phone calls to El Salvador. The measure aims to raise $80 million per year in revenues to help pay for transportation and energy subsidies. The tax was quickly amended to change the method for calculating minutes, payment period and penalties for non-compliance. The amendments also exempt some regional traffic from paying the tax under existing interconnection agreements. U.S. firms are criticizing the tax for violating several international commitments and imposing a tax on future income. End Summary

TAX ON FOREIGN CALLERS TO FUND SUBSIDIES

¶2. (U) The National Assembly passed a law on June 12 to establish a four-cent-per-minute tax on incoming international phone calls terminated in El Salvador. The law took effect on July 24, the same day the Assembly approved amendments to modify the method of calculating minutes, the payment period and penalties for non-compliance. The first tax payment was due on August 20. According to telecom regulator SIGET, El Salvador recorded 2.76 billion minutes of incoming international traffic and 758 million minutes of outgoing international traffic in 2007. Roughly 90% of incoming traffic comes from the U.S.

¶3. (U) The GOES estimates that the tax will raise roughly $80 million per year of additional revenue to be used for "social programs". Shortly after approving the tax in June, the Assembly authorized the GOES to increase public transportation subsidies. The following month, the GOES agreed to double the monthly subsidy for bus and minibus owners to $800 and $400 respectively, in order to avoid a fare increase. The Assembly had approved a 10-cent-per-gallon fuel tax in November 2007 to raise $40 million to maintain the original subsidy through the 2009 elections (reftel). However, subsidies for electricity, propane gas and public transport more than doubled from $82 million in January-June 2007 to $171 million during the same period of 2008.

¶4. (U) The amendments include a "transitory" provision that will exempt some Central American regional traffic from paying the tax under existing interconnection agreements. SIGET will compile traffic volumes from 2007 to exempt equivalent volumes as long as existing agreements are valid. Though ostensibly intended as a temporary measure to comply with regional agreements and honor existing contracts, SIGET's telecommunications manager told Econoff companies will be able to maintain these exemptions indefinitely if they renew their interconnection agreements without changing the terms.

U.S. FIRMS PROTEST

¶5. (U) Several U.S. firms have criticized the new law for violating international commitments and imposing a tax on future income. They

claim the tax is inconsistent with WTO and CAFTA-DR provisions to ensure market access under "reasonable" terms with "cost-oriented rates." The exemption of calls from Central America might also break WTO and CAFTA-DR commitments for equal treatment of trading partners. U.S. firms also argue the tax violates an International Telecommunications Union prohibition on pass-through of taxes.

¶6. (SBU) Americatel manager Tom Gordon told Econoffs his firm will challenge the tax in court and he believes other firms may do the same. He explained that most companies have 30-90 day terms for receivables but the tax is due on the 10th of each month, well before revenues are collected. He warned that the resulting cash-flow problems will likely drive Americatel out of business "within a couple of months".

COMMENT

¶7. (U) The GOES said the tax will help address fiscal challenges caused by energy subsidies without imposing an unpopular domestic tax. However, the tax will fall mostly on Salvadorans who are living in the United States and call home to their relatives in El Salvador. They are already complaining about the tax. In addition to inconsistencies with international commitments, the new tax sends a negative signal to U.S. investors that the GOES will look to U.S. sources to pay for local subsidies.

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